

CHAPTER 15

PROCUREMENT FRAUD & CONTRACT LITIGATION

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CHAPTER 15

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I. INTRODUCTION.

- A. The Contract Disputes Act (CDA), 41 U.S.C. § 605(a), as implemented by FAR 33.210, specifically provides that agency heads (and thus contracting officers) are not authorized to settle, compromise, pay or otherwise adjust any claim involving fraud.
- B. The Federal Circuit has held that the CDA precludes the issue of fraud from being litigated under the CDA – and thus before the boards – since pursuing cases involving fraud is solely the responsibility of the Department of Justice, and such cases must be pursued in a “court of competent jurisdiction.” Simko Constr. Co. v. United States, 852 F.2d 540 (Fed. Cir. 1988).
- C. Boards of Contract Appeals have declined to litigate fraud directly, but have continued to process some appeals by severing the fraud element. Time Contractors, DOTCAB 1669, 86-2 BCA ¶ 19,003. This can create a significant challenge for government attorneys defending appeals involving fraud, since the issue of fraud is often dispositive of the entire case.

II GOVERNMENT POLICY FOR COMBATTING PROCUREMENT FRAUD.

- A. Department of Justice (DOJ) Policy. DOJ policy requires the coordination of parallel criminal, civil, and administrative proceedings so as to maximize the government’s ability to obtain favorable results in cases involving procurement fraud. See U.S. Dep’t of Justice, U.S. Att’ys Man. ch. 1-12.000 (Coordination of Parallel Criminal, Civil, and Administrative Proceedings) June 1998. This is a significant break from past practice, which involved pursuing remedies in sequence.

- B. Department of Defense (DOD) Policy. DOD policy requires the coordinated use of criminal, civil, administrative, and contractual remedies in suspected cases involving procurement fraud. See U.S. DEPT OF DEFENSE, DIR. 7050.5, COORDINATION OF REMEDIES FOR FRAUD AND CORRUPTION RELATED TO PROCUREMENT ACTIVITIES (7 June 1989); U.S. DEP'T OF ARMY, REG. 27-40, LITIGATION, 19 Sept. 1994; U.S. DEP'T OF AIR FORCE, DIR. 51-11, COORDINATION OF REMEDIES FOR FRAUD AND CORRUPTION RELATED TO AIR FORCE PROCUREMENT MATTERS, 21 Oct. 1994; U.S. DEP'T OF NAVY, INST. 5430.92A, OP-008, ASSIGNMENT OF RESPONSIBILITIES TO COUNTERACT FRAUD, WASTE, AND RELATED IMPROPRIETIES WITHIN THE DEPARTMENT OF THE NAVY, (20 Aug. 1987).

1. DOD policy requires each department to establish a centralized organization to monitor all significant fraud and corruption cases.
2. Definition of a “significant” case.
 - a. All fraud cases involving an alleged loss of \$100,000 or more.
 - b. All corruption cases that involve bribery, gratuities, or conflicts of interest.
 - c. All investigations into defective products or product substitution in which a serious hazard to health, safety, or operational readiness is indicated (regardless of loss value).
3. Each centralized organization monitors all significant cases to ensure that all proper and effective criminal, civil, administrative, and contractual remedies are considered and pursued in a timely manner.
4. Product Substitution/Defective Product cases receive special attention.
5. DOD Voluntary Disclosure Program. DOD IG Pamphlet IGDPH 5505.50, Voluntary Disclosure Program—A Description of the Process (April, 1990).

III. PLAYERS INVOLVED IN FRAUD ABATEMENT.

- A. DOD Inspector General. Inspector General Act of 1978, Pub. L. 95-452, as amended by Pub. L. No. 97-252; DOD Dir. 5106.1, Inspector General of Department of Defense (Mar. 14, 1983).
- B. Military Criminal Investigative Organizations.
- C. Department of Justice. DOD Dir. 5525.7, Memorandum of Understanding Between Department of Defense and Department of Justice Relating to the Investigation and Prosecution of Certain Crimes (Jan. 22, 1985).
- D. Procurement Fraud Branch, CAD. AR 27-40, Litigation, Ch. 8.
- E. Procurement Fraud Advisors (PFA) (subordinate commands) - ensure that commanders and contracting officers pursue, in a timely manner, all applicable criminal, civil, contractual, and administrative remedies.

IV. CONTRACTING OFFICER AUTHORITY.

- A. Actions Clearly Exceeding KO Authority. The Contract Disputes Act, 41 U.S.C. § 605(a), as implemented by FAR 33.210, prohibits any contracting officer or agency head from settling, paying, compromising or otherwise adjusting any claim involving fraud.
- B. Actions Clearly Within KO Authority.
 - 1. Refusing Payment. It is the plain duty of administrative, accounting, and auditing officials of the government to refuse approval and to prevent payment of public monies under any agreement on behalf of the United States as to which there is a reasonable suspicion of irregularity, collusion, or fraud, thus reserving the matter for scrutiny in the courts when the facts may be judicially determined upon sworn testimony and competent evidence and a forfeiture declared or other appropriate action taken. To the Secretary of the Army, B-154766, 44 Comp. Gen. 111 (1964).

2. Suspend Progress Payments. 10 U.S.C. § 2307(e)(2); Brown v. United States, 207 Ct. Cl. 768, 524 F.2d 693 (1975); Fidelity Construction, DOT CAB No. 1113, 80-2 BCA ¶ 14,819.
3. Withhold Payment.
 - a. When a debarment/suspension report recommends debarment or suspension based on fraud or criminal conduct involving a current contract, all funds becoming due on that contract shall be withheld unless directed otherwise by the Head of the Contracting Activity (HCA) or the Commander, U.S. Army Legal Services Agency. AFARS 9.406-3.
 - b. Labor standards statutes provide for withholding for labor standards violations. WHA – 41 U.S.C. § 36; DBA – 40 U.S.C. § 276a-2; SCA – 41 U.S.C. § 353(a).
 - c. Specific contract provisions may provide for withholding (e.g., service contract deductions for deficiencies in performance).
 - d. Terminate Negotiations. FAR 49.106 (terminate settlement discussions regarding a terminated contract upon suspicion of fraud); K&R Eng'g Co., Inc., v. United States, 222 Ct. Cl. 340, 616 F.2d 469 (1980).
 - e. Determine Contractor to be Nonresponsible. FAR Subpart 9.4.

V. REPORTING REQUIREMENTS.

- A. Indicators of Fraud. Indicators of Fraud in DOD Procurement, IG, DOD 4075.1-H (June 1987). Common examples include:
 1. Anticompetitive Activities. 15 U.S.C. § 1.

2. False Statements. 18 U.S.C. § 1001.
3. False Claims. 18 U.S.C. § 287.

B. Upon receiving or uncovering substantial indications of procurement fraud:

1. PFA should report the matter promptly to their supporting Army Criminal Investigation Command (USACIDC) element.
2. In such cases, the PFA must also submit a “Procurement Flash Report” to Procurement Fraud Branch. The flash report should contain the following information:
 - a. Name and address of contractor;
 - b. Known subsidiaries of parent firms;
 - c. Contracts involved in potential fraud;
 - d. Nature of the potential fraud;
 - e. Summary of the pertinent facts; and
 - f. Possible damages.
3. DFARS 209.406-3 Report. The contracting officer is also required to submit an investigative-referral report.
4. Remedies Plan. In significant cases, the PFA must prepare a comprehensive remedies plan. The remedies plan should include the following:
 - a. Summary of allegations;
 - b. Statement of adverse impact on DOD mission;

- c. Statement of impact upon combat readiness and safety of DA personnel; and
 - d. Consideration of each criminal, civil, contractual, and administrative remedy available.
- 5. Litigation Report. If the PFA determines that a civil proceeding, such as under the Civil False Claims Act, may be appropriate, the PFA should consult Procurement Fraud Branch to determine if a litigation report is necessary.

VI. NON-CONTRACTUAL REMEDIES.

A. Criminal Remedies.

- 1. Conspiracy to Defraud, 18 U.S.C. § 286, 18 U.S.C. § 371.
- 2. False Claims, 18 U.S.C. § 287.
- 3. False Statements, 18 U.S.C. § 1001.
- 4. Mail Fraud and Wire Fraud: 18 U.S.C. §§ 1341-43.
- 5. Major Fraud Act. 18 U.S.C. § 1031.
- 6. Title 10 (UCMJ) Violations.

B. Civil Remedies.

- 1. The Civil False Claims Act. 31 U.S.C. §§ 3729-33 (1988). The primary litigation weapon for combating fraud is the Civil False Claims Act.

2. Liability Under the False Claims Act. 31 U.S.C. § 3729(a), imposes liability on any person (defined comprehensively in 18 U.S.C. § 1 (1988) to include “corporations, companies, associations, partnerships . . . as well as individuals”) who:

- a. Knowingly presents, or causes to be presented, to an officer or employee of the United States government or a member of the Armed Forces of the United States, a false or fraudulent claim for payment or approval. United States v. Krizek, 111 F.3d 934 (D.C. 1997).
- b. Conspires to defraud the government by having a false or fraudulent claim allowed or paid.
- c. Knowingly makes, uses, or causes to be made or used, a false record or statement to conceal, avoid, or decrease an obligation to pay or transmit money or property to the United States.

3. Damages.

- a. Treble Damages are the substantive measure of liability. 31 U.S.C. § 3729(a); United States v. Peters, 110 F.3d 66 (8th Cir. 1997). Voluntary disclosures of the violation prior to the investigation, preclude the imposition of treble damages.
- b. A civil penalty of between \$5000 and \$10,000 per false claim. 31 U.S.C. § 3729. Imposition is “automatic and mandatory for each false claim.” S. Rep No. 345 at 8-10. See also United States v. Hughes, 585 F.2d 284, 286 (7th Cir. 1978) (“[t]his forfeiture provision is mandatory; it leaves the trial court without discretion to alter the statutory amount.”)

C. Administrative Remedies. Debarment and Suspension. 10 U.S.C. § 2393; FAR Subpart 9.4.

- 1. Suspension. Action taken by a suspending official to disqualify a contractor temporarily from Government contracting.

2. Debarment. Action taken by a debarring official to exclude a contractor from Government contracting for a specified period.

VII CONTRACTUAL REMEDIES.

A. Denial of Claims.

1. Section 605(a) of the CDA prohibits an agency head from settling, compromising or otherwise adjusting any claim involving fraud. 41 U.S.C.S § 605(a). This limitation is reflected in FAR 33.210, which states that the authority of a contracting officer to decide or resolve a claim does not extend to the “settlement, compromise, payment, or adjustment of any claim involving fraud.” Subpart 33.209 of the FAR further provides that contracting officers must refer all cases involving suspected fraud to the agency official responsible for investigating fraud.
2. As a practical matter, the term “denial” is a misnomer in that the contracting officer is precluded from making a final decision on a contractor’s claim where fraud is suspected. As such, denial of a claim consists simply of doing nothing with the claim while other courses of action are pursued.
3. Denial of a claim should be viewed as simply the first of possibly many steps in the resolution of a fraudulent claim.

B. Counterclaims Under the CDA.

1. Per 41 U.S.C. § 604: “[i]f a contractor is unable to support any part of his claim and it is determined that such inability is attributable to misrepresentation of fact or fraud on the part of the contractor, he shall be liable to the Government for an amount equal to such unsupported part of the claim in addition to all costs to the Government attributable to the cost of reviewing said part of his claim.”

2. Until recently, this provision of the CDA has been applied in only a small number of cases. This may in part be due to the deterrent effect of this statute. See United States ex. ral. Wilson v. North American Const., 101 F. Supp.2d 500, 533 (S.D. Tex 2000) (district court unwilling to enforce this provision of the CDA because there were “very few cases applying 41 U.S.C. 604”). See also UMC Elecs. v. United States, 249 F.3d 1337 (Fed. Cir. 2001); Larry D. Barnes, Inc. (d/b/a TRI-AD Constructors) v. United States, 45 Fed. Appx. 907 (Fed. Cir. 2002) (provision successfully applied by CAFC).

3. It is not possible to enforce this section of the CDA in litigation before the boards because of the language at 41 U.S.C. Section 605 (a), which states: “[t]he authority of this subsection shall not extend to a claim or dispute for penalties or forfeitures prescribed by statute or regulation which another Federal agency is specifically authorized to administer, settle or determine.” The boards have generally interpreted this language as meaning only Department of Justice (DOJ) has the authority to initiated a claim under this provision. This is because (in the eyes of the boards) only DOJ has the authority to administer or settle disputes involving fraud under the current statutory scheme. See TDC Management, DOT BCA 1802, 90-1 BCA ¶ 22,627.

C. Forfeiture of Fraudulent Claims.

1. Per 28 U.S.C. § 2514, The Forfeiture of False Claims Act: [a] claim against the United States shall be forfeited to the United States by any person who corruptly practices or attempts to practice any fraud against the United States in the proof, statement, establishment, or allowance thereof. In such cases the United States Court of Federal Claims shall specifically find such fraud or attempt and render judgment of forfeiture.

2. The COFC has applied the Forfeiture of False Claims Statute in cases involving fraud committed during both the contract formation and contract administration phase. See American Heritage Bancorp v. United States, 61 Fed. Cl. 376 (2004) (COFC applied Forfeiture of False Claims Statute where contractor fraudulently misstated his financial position prior to contract award in order to secure a government contract). See also O’Brien Gear & Machine Co. v. United States, 591 F.2d 666 (Ct. Cl. 1979), (“Congress intended . . . that every suit brought in the Court of Claims should be subject to the forfeiture provided, on the commission of the specified fraud”); Little v. United States, 152 F. Supp. 84 (Ct. Cl. 1957) (where “fraud was committed in regard to the very contract upon

which the suit is brought, this court does not have the right to divide the contract and allow recovery on part of it”).

D. Default Terminations Based on Fraud.

1. Termination Under Default Clause. FAR 52.249-8 (fixed-price supply and service contracts); FAR 52.249-10 (fixed-price construction contracts).
2. The FAR contains a complete set of Default clauses for use in government contracts. FAR Parts 49 and 52. These clauses vary according to contract type and identify the conditions that permit the government to terminate the contract for default.
 - a. Failure to deliver the product or complete the work or service on time.
 - b. Failure to make progress that endangers completion.
 - c. Failure to perform other provisions of the contract.
3. “[A] default termination is a drastic sanction which should be imposed upon a contractor only for good cause and in the presence of solid evidence.” Lisbon Contractors, Inc. v. United States, 828 F.2d 759 (Fed. Cir. 1987).
4. Default Termination Under Common Law.
 - a. The government’s rights and remedies in the default clauses are in addition to any other rights or remedies provided by law or under this contract. See FAR 52.249-8 and FAR 52.249-10.
 - b. Courts and boards have developed an implied or common-law right to terminate or cancel a contract in order to effectuate the public policy in a statute or regulation. See United States v. Mississippi Valley Generating Co., 364 U.S. 520, reh’g denied 365 U.S. 855 (1961); Four-Phase Sys., Inc., ASBCA No. 26794, 86-2 BCA ¶ 18,924.

- c. A contractor that engages in fraud in dealing with the government commits a material breach, which justifies terminating the entire contract for default. Joseph Morton Co., Inc. v. United States, 3 Cl. Ct. 120 (1983), aff'd 757 F.2d 1273 (Fed. Cir. 1985).

5. Where a contractor challenges the propriety of a default termination before a court or board, the government is not precluded under the CDA from introducing evidence of fraud discovered after the default termination, and using that evidence to support the termination in the subsequent litigation.

a. Some grounds for default termination.

(1). Submission of falsified test reports. Michael C. Avino, Inc., ASBCA No. 317542, 89-3 BCA ¶ 22,156.

(2). Submission of forged performance and payment bonds. Dry Roof Corp., ASBCA No. 29061, 88-3 BCA ¶ 21,096.

(3). Submission of falsified progress payment requests. Charles W. Daff, Trustee in Bankruptcy for Triad Microsystems, Inc. v. United States, 31 Fed. Cl. 682 (1994).

6. Waiver. The Government may inadvertently waive its right to assert fraud as an affirmative defense in a termination for default if it fails to terminate the contract when it first becomes aware of the fraud. Aptus C. v. United States, 61 Fed. Cl. 638 (2004).

E. Voiding Contracts Pursuant to FAR 3.7

1. Subpart 3.7 of the FAR establishes a detailed mechanism for voiding and rescinding contracts where there has been either a final conviction for illegal conduct in relation to a government contract, or an agency head determination of misconduct by a preponderance of the evidence.

2. Authority to void a contract pursuant to Subpart 3.7 of the FAR is derived from:

- a. 18 U.S.C. § 218;
 - b. Executive Order 12448, 50 Fed. Reg. 23,157 (May 31, 1985); and,
 - c. Subsection 27(e)(3) of the Office of Federal Procurement Policy Act (41 U.S.C. § 423).
 - 3. Under this FAR provision, a federal agency shall consider rescinding a contract upon receiving information that a contractor has engaged in illegal conduct concerning the formation of a contract, or there has been a final conviction for any violation of 18 U.S.C. §§ 201-224.
 - 4. The decision authority for this provision is the agency head, which for DOD has been delegated to the Under Secretary of Defense (Acquisition, Technology, and Logistics).
 - 5. No recorded cases of this provision of the FAR being applied.
- F. Suspending Payments Upon a Finding of Fraud, FAR 32.006.
- 1. FAR 32.006 allows an agency head to reduce or suspend payments to a contractor when the agency head determines there is “substantial evidence that the contractor’s request for advance, partial, or progress payments is based on fraud.”
 - 2. The authority of the agency head under this provision may be delegated down to Level IV of the Executive Schedule, which for the Department of the Army is the Assistant Secretary of the Army for Acquisition, Logistics, and Technology (ASA (ALT)).
 - 3. This provision of the FAR is a potentially powerful tool in that the government can stay payment of a claim without the danger of a board treating the claim as a deemed denial, thus forcing the government into a board proceeding before the government’s case can be developed.

4. Only one recorded board decision involving this provision of the FAR. TRS Research, ASBCA No. 51712, 2001-1 BCA ¶ 31,149 (contracting officer suspended payment on invoices pending completion of an investigation involving fraud allegation, but failed to seek written permission from the agency head to take such action; ASBCA found the government in breach of the contract and sustained the appeal).

G. Voiding Contracts Pursuant to the Gratuities Clause, FAR 52.203-3.

1. Allows DOD to unilaterally void contracts upon an agency head finding that contract is tainted by an improper gratuity. Decision authority for the Department of the Army has been delegated to the ASA (ALT).
2. Authority stems from 10 U.S.C. § 2207, which requires the clause in all DOD contracts (except personal service contracts).
3. Considerable due process protections for the contractor.
4. Exemplary damages of between three to ten times the amount of the gratuity.
5. Procedures used very effectively in response to a fraudulent bidding scheme centered out of the Fuerth Regional Contracting Office, Fuerth, Germany. See Schuepferling GmbH & Co., ASBCA No. 45564, 98-1 BCA ¶ 29,659; ASBCA No. 45565, 98-2 BCA ¶ 29,739; ASBCA No. 45567, 98-2 BCA ¶ 29,828; Erwin Pfister General-Bauunternehmen, ASBCA Nos. 43980, 43981, 45569, 45570, 2001-2 BCA ¶ 31,431; Schneider Haustechnik GmbH, ASBCA Nos. 43969, 45568, 2001 BCA ¶ 31,264.

VIII. BOARD'S OF CONTRACT APPEAL TREATMENT OF FRAUD.

A. Jurisdiction.

1. Theoretically, the boards are without jurisdiction to decide appeals tainted by fraud.

- a. Under the CDA, “[e]ach agency board shall have jurisdiction to decide any appeal from a decision of a contracting officer (1) relative to a contract made by its agency, and (2) relative to a contract made by any other agency when such agency or the Administrator has designated the agency board to decide the appeal.” 41 U.S.C. § 607(d).
- b. Because the CDA precludes contracting officers from issuing final decisions where fraud is suspected, and the boards only have jurisdiction over cases that can be decided by a contracting officer, the boards are effectively barred from adjudicating appeals involving fraud. See 41 U.S.C. § 605(a).
- c. As a practical matter, the boards exercise a form a de facto jurisdiction in that a decision concerning a motion to dismiss an appeal for fraud will have a dispositive effect on the case.

B. Dismissals, Suspensions and Stays.

- 1. Government must demonstrate that the possibility of fraud exists or that the alleged fraud adversely affects the Board’s ability to ascertain the facts. Triax Co., Inc., ASBCA No. 33899, 88-3 BCA ¶ 20,830.
- 2. Mere allegations of fraud are not sufficient. General Constr. and Dev. Co., ASBCA No. 36138, 88-3 BCA ¶ 20,874. Four-Phase Systems, Inc., ASBCA No. 27487, 84-1 BCA ¶ 17,122.
- 3. Boards generally refuse to suspend proceedings except under the following limited circumstances:
 - a. When an action has been commenced in a court of competent jurisdiction, by the handing down of an indictment or by filing of a civil action complaint, so that issues directly relevant to the claim before the board are placed before that court;
 - b. When the Department of Justice or other authorized investigatory authority requests a suspension to avoid a conflict with an ongoing criminal investigation;

- c. When the government can demonstrate that there is a real possibility that fraud exists which is of such a nature as to effectively preclude the board from ascertaining the facts and circumstances surrounding a claim; and
 - d. When an appellant so requests to avoid compromising his rights in regard to an actual or potential proceeding. See Fidelity Constr., 80-2 BCA ¶ 14,819 at 73,142.
 - 4. The fraudulent conduct alleged must be specific to the contract before the board. See Giuliani Associates, Inc., ASBCA Nos. 51672, 52538, 2003 ASBCA LEXIS 92 (Sept. 9, 2003) (contractor convicted for false statements made in connection with a government contract; ASBCA held agency did not have the right to terminate for default a contract for similar services which was not implicated in the conviction).
- C. Fraud as an Affirmative Defense.
- 1. Most often, the government elects to treat fraud as a jurisdictional bar, and pursues the issue in a motion to dismiss.
 - 2. When fraud is cited as an affirmative defense, the boards generally treat the issue consistent with cases where it is presented as a jurisdictional bar. See ORC, Inc., ASBCA No. 49693, 97-1 BCA ¶ 28,750.

IX. CONCLUSION.

- A. For government counsel, when fraud is at issue the ASBCA can be a hostile environment. Since the Forfeiture of Claims and CDA Counterclaims Statutes are not available before the board, quite often the only thing a contractor has to lose in bringing an appeal is the fact they may be giving the government a discovery opportunity.
- B. Coordination is crucial in fraud cases. Numerous parties have a vested interest in the outcome of the case.

- C. If you can get the DOJ to secure an indictment or conviction, this in turn will greatly simplify your efforts to secure a stay or dismissal from the board. Unfortunately, the Federal Sentencing Guidelines Manual does not make such cases very attractive to an Assistant US Attorney with a heavy caseload.
- D. There are no easy fixes. Cases involving fraud can get extremely complicated and often take years to resolve.